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CHARLES ELMORE CROPLEY
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In The

SUPREME COURT OF THE UNITED STATES

October Term, 1942

No. 724

CENTRAL WEST COAL COMPANY, a corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit and Brief in Support thereof.

IRVING A. PUCHNER,
STANLEY E. EASTMAN,
B. F. SALTZSTEIN,
Counsel for Petitioner.

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To the Chief Justice of the United States and Associate Justices of the Supreme Court of the United States—

May It Please the Court:

The Petition of the Central West Coal Company respectfully shows to this Honorable Court:

A.

STATEMENT OF MATTER INVOLVED.

The Commissioner of Internal Revenue on November 22, 1939 served notice on the Petitioner, Central West Coal

Company, of an additional assessment of income taxes for the years 1937 and 1938 upon undistributed income. Subsequently, claims for refunds for the same year for income taxes paid on undistributed income were filed by the Petitioner. The claims for refunds were based on the same facts and law upon which Petitioner claimed the right to have the deficiency assessments set aside. The taxes involved total $18,291.44.

The United States Board of Tax Appeals approved of the determination of deficiencies by the Commissioner and denied any refunds. The Circuit Court of Appeals for the Seventh Circuit approved the decision of the Board of Tax Appeals.

STATUTE INVOLVED.

The statute involved is Section 26 (c) (1) of the Revenue Act of 1936. It provides as follows:

> "In the case of a corporation, the following credits shall be allowed to the extent provided in the various sections imposing tax—
>
> * * *
>
> (c) **Contracts Restricting Payment of Dividends.**
>
> (1) *Prohibition on payment of dividends.*—An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends."

The questions raised under the foregoing statute were whether, by reason of provisions contained in the Articles of Incorporation of the Petitioner setting out the rights and

privileges of the preferred stock and in the trust mortgage respecting dividends, the Petitioner was prohibited by a written contract from paying dividends on its common stock.

The Petitioner, Central West Coal Company, is engaged in the wholesale and retail coal business. Its capital structure consists of common stock, preferred stock, and first mortgage bonds.

RESTRICTIONS IN ARTICLES OF INCORPORATION AND TRUST DEED ON PAYMENT OF DIVIDENDS ON COMMON STOCK.

In April of 1921, the Articles of Incorporation of the Petitioner were amended to provide for the issuance of $100,000 of preferred stock (R. 60). The terms upon which the preferred stock was issued so far as they are material to this case are as follows (R. 49):

" * * *

"The capital stock of the corporation hereby organized is the sum of Two Hundred and Fifty Thousand Dollars, of which One Hundred and Fifty Thousand Dollars shall be common stock, and One Hundred Thousand Dollars shall be preferred stock.

"The holders of such preferred stock shall be entitled to receive, in preference to all other stock of the company now or hereafter authorized, but only when and as declared by the board of directors, and only from the surplus or net profits of the company when and as determined by the board of directors, dividends at the rate of, but not exceeding, seven per centum per annum from the date of the issue of the stock, payable semi-annually, upon such dates as the board of directors may from time to time determine. *Such dividends shall be cumulative, so that if at any time all dividends on the preferred stock at the rate of seven per centum per annum up*

to such time shall not have been declared and paid or a sum sufficient for the payment thereof set apart and appropriated to such payment, the deficiency shall be paid or a sum sufficient for the payment thereof set apart and appropriated to such payment before any dividend shall be declared or paid upon or set apart for any other stock of the company. Whenever from time to time all cumulative dividends upon the preferred stock for each previous year and such dividends then accrued for the current year shall have been declared and paid, or a sum sufficient for the payment thereof shall have been set apart and appropriated to such payment, the board of directors may in its discretion declare dividends upon the common or other stock of the company payable out of the then remaining surplus or net profits, and may fix and change the dates for the declaration and payment of such dividends (Italics ours).

* * *

"All of such preferred stock shall be subject to redemption at par on the 1st day of June, A. D. 1936, but the corporation may, however, at any dividend payment period redeem all or any portion of its preferred stock at par with the accrued dividends thereon by giving thirty days' notice of its intention to redeem any stock selected for redemption, by mailing the same to the stockholder at his post office address as shown upon the books of the company. From and after the date of redemption as shown in such notice (unless default be made by the company in the payment of the redemption price pursuant to such notice) all dividends upon such stock shall cease to accrue and all rights of the holders of such stock as stockholders of the company, except the right to receive the redemption price, shall cease and determine."

The last dividend paid on the preferred stock was during the fiscal year May 1, 1932 to April 30, 1933 (R. 29).

On the 25th day of July, 1928, the Petitioner executed a trust deed to secure the payment of $400,000 par value of bonds maturing serially. On August 1, 1931, $40,000,

and each year thereafter \$30,000 of bonds became due (R. 59).

The terms of the trust indenture insofar as they are material to the issues in this case are as follows (R. 49):

"* * *

The Mortgagor covenants that it will not pay any dividend on its common capital stock during the first three years succeeding the date of this indenture, if its earnings together with the earnings of its acquired property for the twelve months immediately preceding shall, after the payment of taxes and depreciation, but before the payment of the interest charges on the bonds issued hereunder, be less than Sixty Thousand Dollars.

"The Mortgagor further covenants that after the expiration of three years from the date hereof it will not pay any dividend upon its common capital stock until the principal of said bonds then maturing and interest on all outstanding bonds, together with service charges, shall have been provided for. Dividends declared within ninety days after the close of the Mortgagor's fiscal year out of the net earnings of such year shall be considered as dividends declared during such fiscal year for the purposes of this section.

"In the event of any misunderstanding or dispute over the proper construction or interpretation of this section and/or its proper application to a given transaction contemplated by the Mortgagor, the determination by a disinterested accountant of recognized good standing selected by the Trustee, shall be final and conclusive upon the parties, and the failure or refusal of the Mortgagor to abide by and follow such determination shall *ipso facto* constitute a default under this mortgage. The expenses of procuring such determination by such public accountant, as aforesaid, shall be borne by the Mortgagor."

The parties to the trust deed construed the words "provided for" in the restrictive clause to mean "earned" and

the undisputed evidence was that such was the accepted meaning in the investment business.

EARNINGS OF PETITIONER.

Though the Petitioner retired $40,000 of its bonds on August 1, 1931, and $30,000 annually thereafter (R. 28), earnings were insufficient to provide funds for that purpose. Maturities were first met out of profits, but when they were exhausted, depreciation reserves, working capital and funds realized from the sale of assets were resorted to (R. 27).

The fiscal year of the Petitioner commences on May 1st and ends the April 30th next following. During the period May 1, 1930 to April 30, 1938, the end of the last tax year in question, the Petitioner paid $250,000 in bonds that matured. During the same period net profits from its business were $2,616.55. During the period May 1, 1930 to April 30, 1937, the end of the first tax year in question, Petitioner paid $220,000 in bonds and suffered a net loss of $31,879.65 (R. 24-5).

At the beginning of the period May 1, 1930 to April 30, 1938, the Petitioner had an earned surplus of $167,149.95 (R. 53). Charging against the sum the amounts paid for dividends, interest, retirements of bonds, and retirement of preferred stock, a deficit to earned surplus of $141,-534.50 existed at the end of the period (R. 57). If only bond maturities and interest are charged to earned surplus, the deficit is $91,189.75.

If the period commencing May 1, 1930 is ended April 30, 1937, the end of the first tax year, the deficit to earned surplus, if redemption of preferred stock and accrued dividends thereon, as well as interest and bond maturities, are charged to earned surplus, is $159,530.70 (R. 57). If only

bond maturities and interest paid are charged to earned surplus, the deficit is $93,977.95.

The fiscal year ended April 30, 1931, was the last year in which dividends were paid on the common stock. The dividends were paid out of profits of the previous twelve months (R. 28).

B.

JURISDICTION OF THIS COURT.

The decision of the United States Circuit Court of Appeals for the Seventh Circuit was filed November 11, 1942. This petition was filed within three months after that date. This court has jurisdiction to review the decision of the Circuit Court of Appeals for the Seventh Circuit by virtue of Section 240 of the Judicial Code, as amended, (28 U. S. C. A. 347, 350) and Rule 38 of the Rules of the Supreme Court.

C.

QUESTIONS PRESENTED.

The questions presented are:

1. Are the Articles of Incorporation and the provisions thereof set out in the preferred stock certificate prohibiting payment of dividends on the common stock until dividends on the preferred stock with all arrearages have been paid, a written contract within the meaning of Section 26 (c) (1)?

2. The parties to the trust mortgage construed it to mean that the Petitioner was prohibited from paying dividends on its common stock until the principal of the bonds then maturing and interest and charges had been paid out of earnings. Is that construction, adopted by the parties, the best evidence as to the meaning of the contract?

D.

REASON RELIED ON FOR THE ALLOWANCE OF THE WRIT.

1. The decision of the Circuit Court of Appeals for the Seventh Circuit in this case is in conflict with the decision of the Circuit Court of Appeals for the Third Circuit.

> *Lehigh Structural Steel Co. vs. Comm.* (C. C. A. 31), 127 F. (2d) 67.

In that case it was held that a provision in a preferred stock certificate restricting payment of dividends was a contract within the meaning of Section 26 (c) (1).

2. The decision of the Circuit Court of Appeals for the Seventh Circuit is in conflict with the applicable decision of this court and general law. Those decisions hold that the construction placed upon a contract by the parties is the best evidence as to its meaning.

> *Chicago vs. Sheldon*, 75 U. S. (9 Wall 50, 54; 19 L. Ed. 594);
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> *Page on the Law of Contracts*, Section 2034, 1919-1920 Supplement and Second Edition.

Wherefore, Petitioner respectfully prays that a writ of certiorari issue under the seal of this court to review the decree of the Circuit Court of Appeals for the Seventh Circuit in the above case, and that said decree be reversed.

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